

Results are summarized in Table 5. Five clusters included most of the franchises; fifteen franchises were distributed among five other clusters implying that their characteristics were somehow unique and dramatically different from the majority of sampled franchises.

**Table 5. Summary of Rate Differences Within Franchise Clusters**

<u>Cluster ID<sup>(a)</sup></u>	<u>Sample Subgroup</u>	<u>No. of Small Franchises</u>	<u>Average Revenue</u>	<u>No. of Large Franchises</u>	<u>Average Revenues</u>
A (2)	Non-comp.	0	NA	15	\$22.75
	Competitive	0	NA	1	24.74
B (3)	Non-comp.	35	\$20.11	47	22.44
	Competitive	7	13.28	5	22.86
C (4)	Non-comp.	26	21.11	15	23.77
	Competitive	5	17.70	2	22.00
D (7)	Non-comp.	132	21.27	20	21.02
	Competitive	11	15.80	2	17.62
E (9)	Non-comp.	14	21.85	53	22.62
	Competitive	6	15.15	9	23.28
All Others	Non-comp.	0	NA	12	23.53
	Competitive	0	NA	0	NA

(a)Number in ( ) refers to Cluster ID number in computer output given in Volume 2.

Comparisons of average revenue (ARIEPS) within each of the four main clusters simply confirmed the contention that a competitive price differential exists only among franchises operated by small systems.

For the sake of completeness, we also determined the basic features of franchises clustered together. To do this, we performed a Principal Component Analysis (PCA) within each cluster to identify those attributes that were dominant in forming each cluster. Results are given in Volume 2 and discussed in Section 3.2 of the report.

### 3.3 Analysis of Variance (ANOVA)

We also examined the interactive effect of the two key classification variables (i.e., competitiveness and size) on the observed variation in average revenue (ARIEPS). Although several approaches could be considered, we assumed a general linear (Analysis of Variance) model with three levels characterizing size as follows:

Level	No. of Subscribers in System
Small	Less than 3,000
Medium	Between 3,000 and 15,000
Large	More than 15,000

Due to the relatively small number of competitive franchises, this stratification seemed adequate to capture a nonlinear "size" effect, if it exists. Consistent with our objective of accounting for economic factors, as well as enhancing the capability to detect significant differences with respect to size and competitiveness, we included in the model a covariate term representing cost and investment factors. In fact, two covariate terms were included based on the first two Principal Components obtained from a PCA of all 23 factors. The complete computer output of both the PCA and ANOVA runs is given in Volume 2.

The ANOVA results revealed that system size and competitive status produced a highly significant interactive effect on ARIEPS. Consistent with findings discussed previously, there is no evidence of a competitive effect for large systems, here defined as systems serving more than 15,000 subscribers. However, ARIEPS for competitive franchises are significantly lower at each of the other two size levels. The ANOVA results are summarized in Table 6; values given in the table are estimates (least-squares means) that are appropriate for (i) unequal cell sizes (that is, the different number of franchises among the six categories), and (ii) accounting for the cost/investment measures introduced as a covariate.

**Table 6. Analysis of Variance Results  
(Least-Squares Means)**

Size Category	Noncompetitive		Competitive	
	No. of Obs.	ARIEPS	No. of Obs.	ARIEPS
Small	184	\$20.83	19	\$15.00
Medium	83	\$21.94	14	\$16.59
Large	103	\$22.11	17	\$21.84

The implication of this analytical finding is two-fold;

- (i) There is evidence that ARIEPS monotonically increases with system size; the (very) small systems serving less than 3,000 subscribers exhibit significantly lower revenue regardless of competitive status; and
- (ii) Due to the statistical significance of the interactive effect, comparisons of main-effects (i.e., competitive versus noncompetitive) are misleading; benchmark comparisons must necessarily and explicitly take into account system size in order to be meaningful.

#### **4. Regression Diagnostics and Robustness of FCC Analysis**

Regression has many useful applications, one of which is to associate a cause (e.g., competitiveness) with an effect (e.g., lower average revenue) as the FCC purports to have done. However, as with any analytically-sound technique, implicit in its use is strict adherence to key underlying assumptions. While it is true that all assumptions are rarely met in practice, it is nonetheless of critical importance that data analysts and decision-makers alike recognize the impact of potentially serious violations of assumptions necessary for results to be valid.

Recent publications in the statistical literature deal extensively with techniques for assessing validity. Two of the more popular texts are *Regression Diagnostics* by Belsley, Kuh and Welsch (Wiley, 1990) and *Robust Regression and Outlier Detection* by Rousseeuw & Leroy (Wiley, 1987). Although the procedures discussed in these texts are highly technical and require specialized expertise in their application, the implementation of the FCC regression model as a "predictor" or benchmark for setting rates more than justifies their relevance and consideration. It is not uncommon to hear that "statistics can prove just about anything"; nor, unfortunately, is data-dredging an infrequent occurrence. In light of these, as well as more constructive criticisms, it is extremely important that the FCC sample data, regression analysis, and subsequent results be subjected to a comprehensive treatment of diagnostic techniques currently available in the statistical literature as cited above.

A thorough application of diagnostic procedures is time-consuming and it was beyond the scope of our assignment. Nevertheless, we have attempted to identify outliers, i.e., spurious observations, influential data points, and sources of collinearity that, if present and undetected, could seriously affect model stability.

We address the following fundamental concerns:

- (i) The effect of weighting observations (i.e., franchises) according to size;
- (ii) Problematic statistical issues inherent in the FCC analysis;
- (iii) The use and interpretation of some standard regression diagnostic techniques.

**Weighting by Size** - Much of the discussion and controversy surrounding the use of the model as a benchmark focuses on the "size" issue. The model is derived from franchises that represent a disproportionately small number of subscribers served by the cable industry. One way to compensate for this imbalance is to weight each observation according to the number of subscribers served by the system that operates the franchise. In effect, instead of exerting equal influence on the derivation of regression coefficients, a franchise representing 20,000 subscribers is considered ten times more influential than a counterpart representing 2,000 subscribers. Stated another way, the analysis is equivalent to using ten observations for the former and one for the latter as input to the analysis.

In Table 7, we present the results of the FCC model when weighting each of the 420 observations according to size. The key result here is that the coefficient associated with the OVL term, used by the FCC to quantify the competitive effect, essentially disappears; that is, the estimated coefficient is 0.0016 with a relatively large standard error of 0.033.

**As a consequence, OVL (or, equivalently, competition in the FCC definition) has no explanatory power whatsoever with respect to ARIEPS (revenue).**

The implication of this finding is crucial to the FCC argument. By directly accounting for size in the data, it is not surprising that a totally different outcome has been observed. Furthermore, the influence of the make-up of the data set used to derive the model has been demonstrated to have a significant impact on the value and interpretation of individual coefficients in the model. It is this type of data-sensitivity that often (and justifiably) casts doubt on a strict interpretation of individual regression coefficients.

**Problematic Statistical Issues** - In addition to the issue of representativeness of sampled franchises, several other fundamental concerns should be addressed. For example, the OVL term is critical to the FCC claim that competition effectively reduces ARIEPS. Furthermore, the effect is quantified to be approximately 17%. However, theory dictates (and most practitioners acknowledge) that independent variables used in regression models should be measured precisely (i.e., without error). In varying degrees, several of the thirteen terms used in the FCC model are subject to uncertainty; the problem seems particularly acute when quantifying OVL. In fact, as discussed elsewhere, OVL is known to have been incorrectly specified for some of the franchises contacted in our survey.

Another common difficulty encountered in regression is the condition of collinearity. Collinearity occurs when explanatory variables themselves, assumed to be independent, are correlated in the statistical sense. This condition, if it exists, can cause havoc on the interpretation of individual coefficients, namely, OVL. Correlation tables given in Volume 2 reveal that OVL is correlated with other terms in the model, indicating that caution should be exercised in interpreting coefficients that supposedly isolate the effect attributable to a competitive environment.

**Table 7. FCC Regression with Observations Weighted According to Size**

NCTA - Analysis of Survey Results

Regression - FCC model

08:46 Tuesday, May 24, 1994

1

Model: MODEL1

Dependent Variable: LAR

Analysis of Variance

Source	DF	Sum of Squares	Mean Square	F Value	Prob>F
Model	13	9.54798	0.73446	21.048	0.0001
Error	406	14.16692	0.03489		
C Total	419	23.71490			

Root MSE	0.18680	R-square	0.4026
Dep Mean	3.09489	Adj R-sq	0.3835
C.V.	6.03573		

Parameter Estimates

Variable	DF	Parameter Estimate	Standard Error	T for H0: Parameter=0	Prob >  T	Variance Inflation
INTERCEP	1	2.327475	0.21715957	10.718	0.0001	0.00000000
AL	1	-0.036631	0.01400663	-2.615	0.0092	1.15162914
OVL	1	0.001609	0.03271645	0.049	0.9608	1.28036762
C	1	-0.310389	0.11129948	-2.789	0.0055	1.02678762
MSO	1	-0.045196	0.03366448	-1.343	0.1802	1.53227544
LMS	1	0.003488	0.00364090	0.936	0.3498	1.47631336
RSS	1	14.896592	19.32380616	0.771	0.4412	1.07395613
RTC	1	-3.418992	1.02866834	-3.324	0.0010	1.39188559
PNB	1	0.215312	0.10589860	2.033	0.0427	1.73554569
PAO	1	0.022056	0.01881679	1.172	0.2418	1.32681508
PRM	1	0.190423	0.02483618	7.667	0.0001	1.42997103
PT2	1	0.092545	0.01901554	4.867	0.0001	2.02512396
PTC	1	0.040798	0.13081441	0.312	0.7553	1.12087355
LIN	1	0.061816	0.01676105	3.688	0.0003	1.58045409

Another major concern involves the data set itself. Even if all measures were reasonably accurate (which has been demonstrated not to be the case), there is further evidence that subsets of the data have a disproportionate influence on the FCC estimated model. The importance of influential observations is emphasized in the following quote, extracted from the aforementioned text authored by Belsley, Kuh and Welsch (page 3):

"The fact that a small subset of the data can have a disproportionate influence on the estimated parameters or predictions is of concern to users of regression analysis, for, if this is the case, it is quite possible that the model estimates are based primarily on this data subset rather than on the majority of the data."

While the authors point out that unusual or influential data points are not necessarily bad, it is only after they have been identified that their quality can be assessed and appropriate action taken. In the context of the rate-setting application, it is important that such data points be appropriately handled.

**Regression Diagnostics** - Our regression output generated by the SAS PROC REG software package includes an array of diagnostic measures. Criteria for interpreting these measures are discussed in the literature and will not be explained here. As a simple illustrative example, one of the measures (the studentized residual) provides insight concerning observations (franchises) that yield extreme discrepancies between actual ARIEPS and the corresponding value estimated by the model. A few of the differences that are highly significant are listed in Table 8.

**Table 8. Sample Franchises with Large Prediction Error**

Franchise	ARIEPS (Actual)	ARIEPS (Predicted)	Residual (Difference)	
XX 0003	\$ 7.50	\$18.23	-\$10.73	Model Over- Predicts
MO 0373	\$11.80	\$22.79	-\$10.99	
AL 0127	\$11.07	\$19.49	-\$ 8.42	
GA 0025	\$13.71	\$22.14	-\$ 8.43	
GA 0025	\$13.48	\$20.09	-\$ 6.61	
KY 0007	\$10.22	\$16.41	-\$ 6.19	
NJ 0373	\$29.58	\$17.66	+\$11.92	Model Under- Predicts
NJ 0373	\$26.95	\$19.12	+\$ 7.83	
NH 0019	\$35.84	\$22.55	+\$13.29	
NY 1414	\$32.23	\$21.85	+\$10.38	
CA 1119	\$28.05	\$19.28	+\$ 8.77	

In addition to the fact that the FCC model is obviously a poor predictor of revenue for these few franchises, inspection of other diagnostic measures (not included here) suggested that several of these franchises were indeed highly influential. This does not necessarily imply that they should have been deleted, but it does suggest a need to *verify the data* collected for these franchises.

It was not the intent of our assignment to conduct a thorough diagnostic evaluation of the FCC regression model. If it were, we would have first eliminated apparent errors in the data base, and subsequently attempted to reconcile other discrepancies that have been detected. Rather, the purpose of this discussion is to emphasize the possible significance of potential data problems to the FCCs estimation of the competitive price differential, and to pinpoint the estimated coefficients (primarily the one associated with the OVL term) that are potentially most adversely affected.

## **Appendix 2**

# **Survey of Competitive Franchises**



## **Appendix 2**

### **Interview Guide**

# Interview Guide

pds/24April94

## Objective

Arthur D. Little Inc. is helping NCTA and CATA respond to the FCC's rulemaking on cable TV rates. The FCC based its new rules on cable system rates and services as of September 1992. Our questions concerning your system will help NCTA and CATA comment on the FCC's approach.

## FACILITIES

1. What addressable & non-addressable converters are in your system? (CHECK DATASHEET ON ADDRESSABILITY)
  - Suppliers & Model numbers?
  - How obtained: Purchased new? Used? Transferred from other systems?
  - When obtained?
  - Proportions of subscribers having each model of converter? Do these proportions differ for franchise area vs. overall system?
  - Changes since September 1992?
2. What is the channel capacity of your system in the franchise area? (CHECK DATASHEET ON CHANNEL CAPACITY)
  - How many channels activated?
  - Differences between franchise area and overall system?
  - Differences between overbuilt portions and rest of franchise area?
  - Change in channel capacity since September 1992?
3. Do you have a local origination or public access studio?
  - Cost to set up this studio? When built?
4. Do you operate any other facilities required by the franchise agreement, e.g., institutional network for town government, or for schools?
  - Cost to build these facilities? When constructed?
5. When was the franchise area constructed? (CHECK DATASHEET ON AGE OF HEADEND)
  - Rebuilds & upgrades since original construction? When? What \$/mile on average?
6. Was franchise area constructed or acquired by current owner?
  - If acquired:*
    - Purchase price? Date of purchase? Subscribers at time of purchase? Existence of overbuild at time of purchase? (CHECK DATASHEET FOR NOTES ON OVERBUILD)
  - If constructed:*
    - Original capital investment for the system in terms of:
      - \$/mile?
      - \$/Home passed?
      - \$/Subscriber
      - Differences for franchise area vs. overall system?

GET NAME & PHONE NUMBER OF COMPANY ENGINEER OR OTHER SOURCE ON CAPITAL INVESTMENT IF THEY CAN ADD MORE INFORMATION.

## **OPERATIONS**

7. How many satellite-delivered cable networks are you providing? (CHECK DATASHEET)
  - How many in tiers above basic?
  - Proportions of subscribers for higher tiers?
  - Differences between franchise area and overall system?
  - Changes since September 1992?
8. How many subscribers for basic? and for each higher tier?
  - How much subscriber churn (%) each year?
  - In franchise area versus overall system?
  - Changes since September 1992?
9. How many employees in the system?
  - In the franchise area (if counted separately)?
  - Number of customer service representatives (CSRs)? System vs. franchise area?
  - Field employees (technicians, installers, supervisors)? System vs. franchise area?
  - Changes since September 1992?
10. Current rates for basic and for each higher tier, per month?(CHECK DATASHEET ON RATES & COMMUNITIES SERVED)
  - Rates for equipment rental?
  - Difference between franchise area vs. other parts of system in surrounding areas?
  - Rate changes since September 1992?
11. Financial performance:
  - Average revenues per subscriber?
  - Average operating expenses per subscriber?
  - Average cash flow per subscriber? or CF margins? (CASH FLOW = INCOME BEFORE DEBT SERVICE, DEPRECIATION, CAPITAL INVESTMENT & TAXES)
  - Revenues per subscriber from *regulated* basic & satellite programming tiers, excluding non-regulated pay cable or other sources?
  - Annual depreciation expense?
  - Differences for franchise area vs. overall system?
  - Changes since September 1992?

## **SPECIAL CONDITIONS**

12. Special conditions in franchise area:
  - Financial situation for one or both systems?
  - Significant rate changes?
  - Changes in system plant and/or services?
  - Special features of overbuilt areas vs. entire franchise areas?

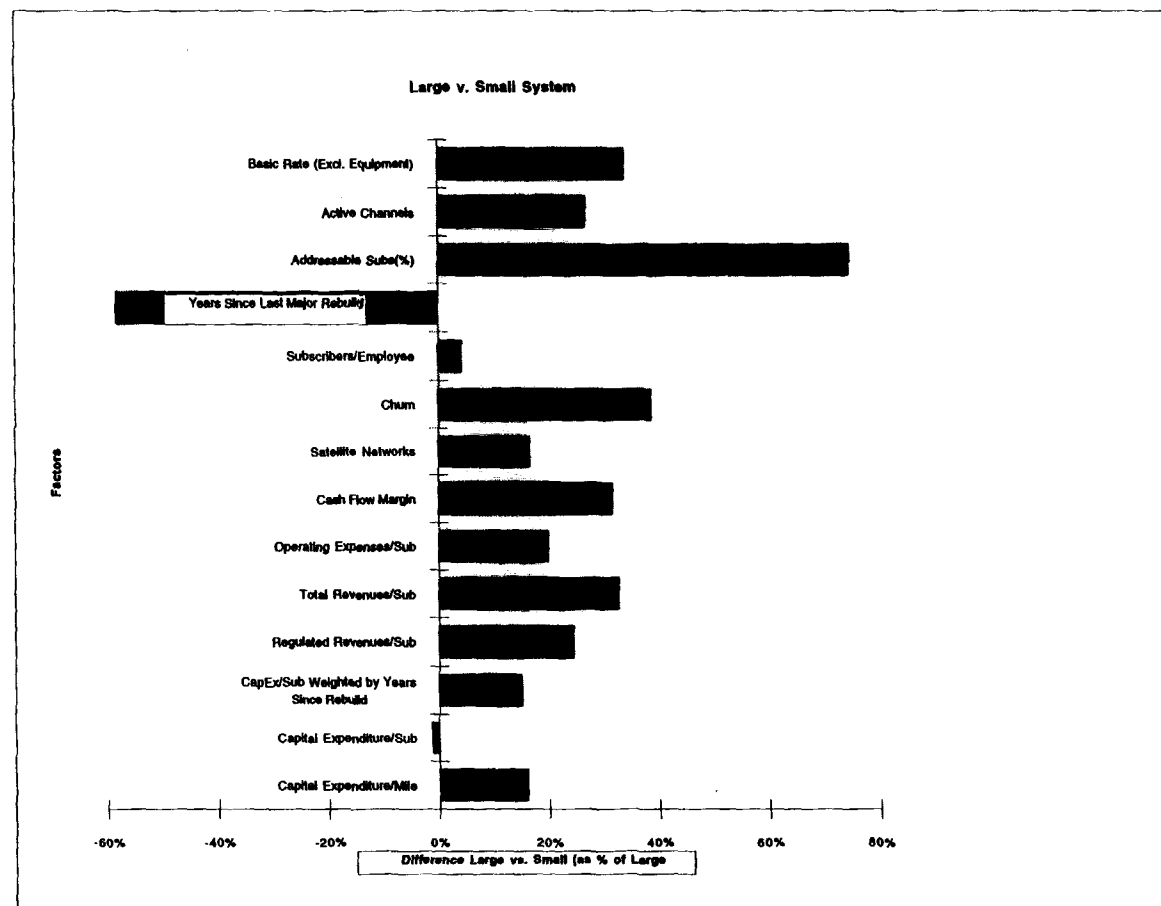
**Appendix 2**  
**Franchise Operational Data**

## Large Vs. Small Systems- Results of ADLittle Survey

1

ADL Survey Results	Subs (Franch)	Subs (Sys)	CapEx/Mile	CapEx/Sub	CapEx*Age/8b	RgtldRevs/Sub	Revs/Sub	Expenses/Sub	CFMargin	SatNets	Churn	Subs/Emp	Age-Bld/Rbid	AddrSubs(%)	ActvChnls	BasicRate	BasicRate Incr
Large	Average-->	5044	42543	\$21,433	\$670	\$344	\$264.65	\$376.27	40%	34	24%	547	5	41%	54	\$22.33	\$1.94
Small	Average-->	1117	1990	\$17,083	\$679	\$292	\$199.79	\$222.56	27%	28	15%	524	8	10%	40	\$14.77	\$0.23
Differences																	
Large-minus-Small (N)		3927	40552	\$3,449	(\$9.05)	\$61.94	\$64.86	\$123.20	13%	6	9%	23	-3	31%	15	\$7.56	\$1.71
Difference v. Large (%)		78%	95%	16%	-1%	15%	25%	33%	20%	32%	17%	39%	4%	-58%	27%	34%	88%

Capital Coverage- (CapEx per Sub)/(Cash Flow per Sub)  
 Large Systems 4  
 Small Systems 9



## Large Vs. Small Systems- Results of ADLittle Survey

Franchisee	Subs (Fr)	Subs (9ys)	Conf. 1988	Conf. 1989	Conf. 1990	Franch. Fee	Inv. Fee	Inv. Fee	Conf. Fee	Sat/Nets	Churn	Subs/Emp/Age	Bld/Rbid	Addr/Subs (%)	Chnlis Actv.	BasicRate	BasicRateCh
Franchisee	>5K Subs																
AL0012	>5K	23314	23314							47	31%	480		21%	60	\$21.50	\$6.00
AL0371	>5K	16235	26613							52		459	8	44%	63	\$19.50	\$4.00
CA0751	>5K	9100	9100							43	3%	650	8	0%	61	\$21.95	\$3.00
FL0679	>5K	1890	18064							35	30%	396	1	18%	42	\$21.16	\$2.21
KY0542	>5K	10273	58956							28		454	11	45%	82	\$20.76	\$0.16
KY0867	*From Smalls	3560	5300							28		324	8	75%	44	\$28.80	\$0
MD0009-W	>5K	11024	26067							45	36%	592	6	89%	62	\$27.96	\$2.20
MD0009-D	>5K	500	26067							45	38%	592	6	89%	62	\$27.96	\$2.20
NE0111	>5K	4329	69228							45	26%	399	10	94%	55	\$22.57	\$2.82
NJ0373-H	>5K	1249	49124							16	20%	692	0.01	38%	42	\$24.67	\$1.72
NJ0373-P	>5K	2799	49124							16	17%	692	0.01	38%	42	\$24.67	\$1.72
NJ0404	>5K	1345	199333							27	8%	623	1	26%	62	\$23.00	\$2.55
OH0264-J	>5K	5878	26500							25		803	5	33%	52	\$19.00	\$1.00
OH0264-T	>5K	782	26500							25		803	5	33%	52	\$19.00	\$1.00
PA0478	>5K																
PA0478	>5K																
PA0552h	>5K	1849	63500									435			65	\$21.15	\$2.65
PA0662e	>5K	3600	63500									435			65	\$21.15	\$2.65
SC0527	*From Smalls	1927	5296							26		662		0%	41	\$16.62	(\$1.38)
WI0621	>5K	202	56000							35	24%	373		85%	48	\$20.65	(\$0.30)
WI0650	>5K	700	10566							45	20%	556	7	0%	45	\$23.95	\$1.00
XX0002	>5K																
MI0011	>5K	332	20705							26	35%	518	1	10%	44	\$21.54	\$3.61
Average-->		5044	42543	\$21,368	\$676	\$244	\$276	\$368	\$223	34	24%	647	5	41%	54	\$22.33	\$1.84
Franchisee	<5K Subs																
AL0127		2415	3388							36	33%	344	7	0%	42	\$9.95	\$0
AL0380-B		329	3053							47	2%	339	8		59	\$14.00	\$0
AL0380-T		2208	3053							47	2%	339	8		59	\$14.00	\$0
GA0025-L		664	3810							28		526	19	3%	37	\$13.45	\$0.55
GA0025-V		2517	3810							28		526	19	2%	37	\$13.45	\$0.55
GA0757		1550	2439							36	55%	610	6	40%	51	\$15.75	\$0.00
GA0881		146	146							15		553	4	0%	20	\$17.00	\$0
IL0883		190	190							28	18%	786	7	0%	36	\$18.40	\$0
IL1474																	
IN0531		280	4300							24		662	10	0%	40	\$21.97	\$2.52
KY0867	*To Large																
LA0085		2711	3525							45	26%	589	3	0%	60	\$16.00	\$0
LA0515																	
OR0146		75	2069							19	2%	690	15	4%	35	\$18.50	\$1.11
OR0258		540	932							20	15%	311	15	0%	31	\$13	\$1.50
SC0527	*To Large																
UT0088		156	156							15	0%	780	7	0%	25	\$17.53	\$0.03
VA0560		467	1467							40		367	2	50%	54	\$14.95	\$0
XX0022		756	606							30	3%	808	6	0%	46	\$16.95	\$3.00
AR0026		4745	4745							40	38%	408	6	23%	54	\$10.50	\$0
AR0576		4136	4136							28	25%	995	2	97%	58	\$12.50	\$0
KY1009																	
MI1005																	
MN0049		527	527							27				0%	36	\$14.95	\$0
MN0115		58	338							8		316	20	0%	18	\$10.95	\$0
MN0182		28	28							15	0%	140	6	0%	25	\$11.95	(\$4.00)
MN0602		527	527							27		580	4	0%	36	\$14.95	\$0
MN0630		330								15	2%	550	3	0%	15	\$13.95	\$0
MN0691		343	343							32	2%	298	2	0%	42	\$15.00	\$0
Average-->		1117	1980	\$17,963	\$678	\$202	\$253	\$280	\$178	28	15%	524	8	10%	40	\$14.77	\$0.23

## **Appendix 3**

# **Financial Analyses**

**Appendix 3**  
**Franchise Financial Data**



**Arthur D. Little Survey of Competitive Franchises: Financial Data**

Jun-94

FRANCHISES	CapEx/Mile	CapEx/Sub	Weighted CapEx/Sub	Revs/Sub	RegRevs/Sub	Exp/Sub	CFMargin
QQ111	\$8,600	\$784	\$392	\$243	\$203	\$195	20%
QQ113	\$15,000	\$1,521	\$634	\$370	\$293	\$179	52%
QQ114				\$366		\$204	44%
QQ115	\$13,728	\$706	\$588	\$226		\$172	24%
QQ116				\$247		\$192	22%
QQ117				\$261	\$177	\$185	29%
QQ122			\$0	\$192			
QQ123			\$0	\$325	\$226	\$172	47%
QQ124	\$13,000	\$600	\$350	\$305	\$244	\$165	46%
QQ125	\$13,000	\$251	\$146	\$360	\$244	\$165	54%
QQ126	\$24,378	\$790	\$724	\$457	\$232	\$224	51%
QQ127	\$23,000	\$374	\$374	\$498	\$287	\$242	51%
QQ128	\$23,000	\$374	\$374	\$498	\$287	\$242	51%
QQ129	\$29,629	\$425	\$71	\$380	\$254	\$233	39%
QQ130	\$20,000	\$459	\$230	\$435	\$343	\$267	39%
QQ131	\$20,000	\$360	\$180	\$430	\$337	\$267	38%
QQ133	\$7,083	\$305	\$229	\$315	\$249	\$157	50%
QQ134	\$16,000	\$875	\$292	\$336		\$240	29%
QQ135	\$50,289	\$1,072	\$89	\$333		\$227	32%
QQ136	\$7,000	\$375	\$63	\$339		\$166	51%
QQ138				\$291	\$223	\$129	55%
QQ139	\$12,000	\$822	\$548	\$321		\$164	49%
QQ140	\$20,000	\$902	\$451	\$261		\$180	31%
QQ141			\$0	\$270		\$205	24%
QQ142			\$0	\$270		\$205	24%
QQ143				\$338	\$228	\$230	32%
QQ144				\$354	\$250	\$248	30%
QQ145		\$650	\$217	\$306		\$222	27%
QQ146		\$650	\$217	\$306		\$222	27%
QQ147	\$21,828	\$812	\$271	\$348		\$228	34%
QQ148				\$213		\$202	5%
QQ149				\$369		\$274	26%
QQ150	\$41,000	\$656	\$547	\$235		\$185	21%
QQ151	\$36,000	\$545	\$409	\$188	\$167	\$132	30%
QQ152	\$21,923	\$983	\$655				
QQ153				\$150		\$120	20%
QQ154			\$0	\$158	\$131	\$206	-30%
QQ157	\$9,500	\$801	\$734	\$336		\$186	45%
QQ159	\$12,500	\$774	\$645	\$206		\$161	22%

## **Appendix 3**

# **Financial Performance Models**

## 1 Cable Financial Returns: Competitive Systems

2

## 3 Financial Assumptions

4 Interest Rate

8.50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p102

5 Debt Leverage on Capital Investment

50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p106-108

6 Debt Repayment

3

7 Starting Year

9

8 Term

9 Overall Rate of Return (AfterTax)

11.25% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108

10 After Tax Return to Equity

14% Derived as In FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108: Eq.Ret=(Avg Return-(%Debt\*Debt Cost))/%Equity

11 Plus Allowed Return for Tax @ Rate:

34%

7.21% Gross up as In FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p83. Formula: Gross up = ((Tax rate/(1-Tax Rate))\* Rate of return

12 Equity Rate of Return (PreTax)

21.21%

13 Terminal Multiple of Cash Flow

9 CF Multiple = 1/Rate of Return

14

15

16

## 17 Cable Franchise

ADL Code

18 Initial Capital Expenditure per Subscriber

\$764 QQ111

19 Annual Capital per Subscriber

\$0 Assumed

20 Revenue per Subscriber

\$243 QQ111

21 Expenses per Subscriber

\$195 QQ111

22 Cash Flow per Subscriber

\$48 QQ111

23 Cash Flow growth assumption (per Yr)

1% Real growth - assumed

24

## 25 Financial Performance

Year--&gt;

26 Annual cash flows

1 2 3 4 5 6 7 8 9 10

27 Plus Terminal Cash

\$48 \$48 \$49 \$49 \$50 \$50 \$51 \$51 \$52 \$52

28 Total Cash flows

\$48 \$48 \$49 \$49 \$50 \$50 \$51 \$51 \$52 \$519

29

30 Interest Cost

\$17 \$33 \$31 \$26 \$21 \$17 \$12 \$7 \$2 \$0

31

32 Net CF Available for Debt Repayment

\$31 \$15 \$18 \$23 \$29 \$34 \$39 \$44 \$50 \$519

33 Debt Repayment

\$0 \$0 \$56 \$56 \$56 \$56 \$56 \$56 \$56 \$0

34

35 Annual Net CF for Equity Returns

(\$392)

\$31 \$15 (\$38) (\$33) (\$27) (\$22) (\$17) (\$12) (\$8) \$519

36

37 IRR to Equity

0%

38 NPV Per Subscriber

39 w/Discount Rate=

21%

(\$262)

40

## 41 Debt Repayment/Interest

42	Year-->										
43	0	1	2	3	4	5	6	7	8	9	10
44											
45 Debt as % Investment=	50%										
46 Annual Investment (\$)	784	0	0	0	0	0	0	0	0	0	0
47 New Debt (\$/year)	392	0	0	0	0	0	0	0	0	0	0
48 New Debt (cum)	392	392	392	392	392	392	392	392	392	392	392
49											
50 DEBT REPAYMENTS											
51 New Debt											
52 new in year 1	0	0	56	56	56	56	56	56	56	56	0
53 new in year 2		0	0	0	0	0	0	0	0	0	0
54 new in year 3			0	0	0	0	0	0	0	0	0
55 new in year 4				0	0	0	0	0	0	0	0
56 new in year 5					0	0	0	0	0	0	0
57 new in year 6						0	0	0	0	0	0
58 new in year 7							0	0	0	0	0
59 new in year 8								0	0	0	0
60 new in year 9									0	0	0
61 new in year 10										0	0
62 new in year 11											0
63 new in year 12											
64 new in year 13											
65 new in year 14											
66 new in year 15											
67											
68											
69 DEBT REPAYMENT (\$/yr)	0	0	56	56	56	56	56	56	56	56	0
70 DEBT REPAYMENT (\$ cum)	0	0	56	112	168	224	280	336	392	392	392
71											
72 PRINCIPAL OUTSTANDING(\$oy)	392	392	336	280	224	168	112	56	0	0	0
73 INTEREST (\$/Year)	17	33	31	26	21	17	12	7	2	0	0
74											
75											
76											
77											

## 1 Cable Financial Returns: Competitive Systems

2

## 3 Financial Assumptions

4 Interest Rate

8.50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p102

5 Debt Leverage on Capital Investment

50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p106-108

6 Debt Repayment

7 Starting Year

3

8 Term

9

9 Overall Rate of Return (AfterTax)

11.25% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108

10 After Tax Return to Equity

14% Derived as in FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108: Eq.Ret=(Avg Return-(%Debt\*Debt Cost))/%Equity

11 Plus Allowed Return for Tax @ Rate:

34%

7.21% Gross up as in FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p83. Formula: Gross up = ((Tax rate/(1-Tax Rate))\* Rate of return

12 Equity Rate of Return (PreTax)

21.21%

13 Terminal Multiple of Cash Flow

9 [CF Multiple = 1/Rate of Return]

14

15

16

17 Cable Franchise

ADL Code

18 Initial Capital Expenditure per Subscriber

\$656 QQ150

19 Annual Capital per Subscriber

\$0 Assumed

20 Revenue per Subscriber

\$235 QQ150

21 Expenses per Subscriber

\$185 QQ150

22 Cash Flow per Subscriber

\$50 QQ150

23 Cash Flow growth assumption (per Yr)

1% Real growth - assumed

24

25 Financial Performance

Year--&gt;

26 Annual cash flows

1	2	3	4	5	6	7	8	9	10
\$50	\$51	\$51	\$52	\$52	\$53	\$53	\$54	\$54	\$55

27 Plus Terminal Cash

\$50	\$51	\$51	\$52	\$52	\$53	\$53	\$54	\$54	\$486
------	------	------	------	------	------	------	------	------	-------

28 Total Cash flows

\$50	\$51	\$51	\$52	\$52	\$53	\$53	\$54	\$54	\$541
------	------	------	------	------	------	------	------	------	-------

29

30 Interest Cost

\$14	\$28	\$28	\$22	\$18	\$14	\$10	\$8	\$2	\$0
------	------	------	------	------	------	------	-----	-----	-----

31

32 Net CF Available for Debt Repayment

\$36	\$23	\$25	\$30	\$34	\$39	\$43	\$48	\$52	\$541
------	------	------	------	------	------	------	------	------	-------

33 Debt Repayment

\$0	\$0	\$47	\$47	\$47	\$47	\$47	\$47	\$47	\$0
-----	-----	------	------	------	------	------	------	------	-----

34

35 Annual Net CF for Equity Returns

(\$328)	\$36	\$23	(\$22)	(\$17)	(\$13)	(\$8)	(\$4)	\$1	\$5	\$541
---------	------	------	--------	--------	--------	-------	-------	-----	-----	-------

36

37 IRR to Equity

5%

38 NPV Per Subscriber

39 w/Discount Rate=

21%

(\$191)

40

## 41 Debt Repayment/Interest

42	Year-->										
43	0	1	2	3	4	5	6	7	8	9	10
44											
45 Debt as % Investment=	50%										
46 Annual Investment (\$)	656	0	0	0	0	0	0	0	0	0	0
47 New Debt (\$/year)	328	0	0	0	0	0	0	0	0	0	0
48 New Debt (cum)	328	328	328	328	328	328	328	328	328	328	328
49											
50 DEBT REPAYMENTS											
51 New Debt											
52 new in year 1	0	0	47	47	47	47	47	47	47	47	0
53 new in year 2		0	0	0	0	0	0	0	0	0	0
54 new in year 3			0	0	0	0	0	0	0	0	0
55 new in year 4				0	0	0	0	0	0	0	0
56 new in year 5					0	0	0	0	0	0	0
57 new in year 6						0	0	0	0	0	0
58 new in year 7							0	0	0	0	0
59 new in year 8								0	0	0	0
60 new in year 9									0	0	0
61 new in year 10										0	0
62 new in year 11											0
63 new in year 12											
64 new in year 13											
65 new in year 14											
66 new in year 15											
67											
68											
69 DEBT REPAYMENT (\$/yr)	0	0	47	47	47	47	47	47	47	47	0
70 DEBT REPAYMENT (\$ cum)	0	0	47	94	141	187	234	281	328	328	328
71											
72 PRINCIPAL OUTSTANDING(eoy)	328	328	281	234	187	141	94	47	0	0	0
73 INTEREST (\$/Year)	14	28	26	22	18	14	10	6	2	0	0
74											
75											
76											
77											

## 1 Cable Financial Returns: Competitive Systems

2

## 3 Financial Assumptions

4 Interest Rate

8.50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p102

5 Debt Leverage on Capital Investment

50% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p106-108

6 Debt Repayment

7 Starting Year

3

8 Term

9

9 Overall Rate of Return (AfterTax)

11.25% FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108

10 After Tax Return to Equity

14% Derived as in FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p108: Eq.Ret=(Avg Return-(%Debt\*Debt Cost))/%Equity

11 Plus Allowed Return for Tax @ Rate:

34%

7.21% Gross up as in FCC Rpt&amp; Order, Docket 93-215, 30Mar94, p83. Formula: Gross up = ((Tax rate/(1-Tax Rate))\* Rate of return

12 Equity Rate of Return (PreTax)

21.21%

13 Terminal Multiple of Cash Flow

9 CF Multiple = 1/Rate of Return

14

15

16

## 17 Cable Franchise

ADL Code

18 Initial Capital Expenditure per Subscriber

\$774 QQ159

19 Annual Capital per Subscriber

\$0 Assumed

20 Revenue per Subscriber

\$208 QQ159

21 Expenses per Subscriber

\$161 QQ159

22 Cash Flow per Subscriber

\$45 QQ159

23 Cash Flow growth assumption (per Yr)

1% Real growth - assumed

24

## 25 Financial Performance

Year--&gt;

26 Annual cash flows

1 2 3 4 5 6 7 8 9 10

27 Plus Terminal Cash

\$45 \$45 \$46 \$46 \$47 \$47 \$48 \$48 \$49 \$49

28 Total Cash flows

\$45 \$45 \$46 \$46 \$47 \$47 \$48 \$48 \$49 \$49

29

30 Interest Cost

\$16 \$33 \$31 \$26 \$21 \$18 \$12 \$7 \$2 \$0

31

32 Net CF Available for Debt Repayment

\$29 \$13 \$15 \$21 \$26 \$31 \$36 \$41 \$46 \$47

33 Debt Repayment

\$0 \$0 \$55 \$55 \$55 \$55 \$55 \$55 \$55 \$0

34

35 Annual Net CF for Equity Returns

(\$387) \$29 \$13 (\$40) (\$35) (\$30) (\$24) (\$19) (\$14) (\$9) \$467

36

37 IRR to Equity

-1%

38 NPV Per Subscriber

39 w/Discount Rate=

21%

(\$290)

40

## 41 Debt Repayment/Interest

42	Year-->										
43	0	1	2	3	4	5	6	7	8	9	10
44											
45 Debt as % Investment--	50%										
46 Annual Investment (\$)	774	0	0	0	0	0	0	0	0	0	0
47 New Debt (\$/year)	387	0	0	0	0	0	0	0	0	0	0
48 New Debt (cum)	387	387	387	387	387	387	387	387	387	387	387
49											
50 DEBT REPAYMENTS											
51 New Debt											
52 new in year 1	0	0	55	55	55	55	55	55	55	0	0
53 new in year 2		0	0	0	0	0	0	0	0	0	0
54 new in year 3			0	0	0	0	0	0	0	0	0
55 new in year 4				0	0	0	0	0	0	0	0
56 new in year 5					0	0	0	0	0	0	0
57 new in year 6						0	0	0	0	0	0
58 new in year 7							0	0	0	0	0
59 new in year 8								0	0	0	0
60 new in year 9									0	0	0
61 new in year 10										0	0
62 new in year 11											0
63 new in year 12											
64 new in year 13											
65 new in year 14											
66 new in year 15											
67											
68											
69 DEBT REPAYMENT (\$/yr)	0	0	55	55	55	55	55	55	55	0	0
70 DEBT REPAYMENT (\$ cum)	0	0	55	111	166	221	276	332	387	387	387
71											
72 PRINCIPAL OUTSTANDING(eoy)	387	387	332	276	221	166	111	55	0	0	0
73 INTEREST (\$/Year)	16	33	31	26	21	16	12	7	2	0	0
74											
75											
76											
77											



## 1 Cable Financial Returns: Competitive Systems

2		
3	Financial Assumptions	
4	Interest Rate	8.50% FCC Rpt& Order, Docket 93-215, 30Mar94, p102
5	Debt Leverage on Capital Investment	50% FCC Rpt& Order, Docket 93-215, 30Mar94, p106-108
6	Debt Repayment	
7	Starting Year	3
8	Term	9
9	Overall Rate of Return (AfterTax)	11.25% FCC Rpt& Order, Docket 93-215, 30Mar94, p108
10	After Tax Return to Equity	14% Derived as in FCC Rpt& Order, Docket 93-215, 30Mar94, p108: $Eq.Ret = (Avg Return - (\%Debt * Debt Cost)) / \%Equity$
11	Plus Allowed Return for Tax @ Rate-	34% 7.21% Gross up as in FCC Rpt& Order, Docket 93-215, 30Mar94, p63. Formula: Gross up = $((Tax rate / (1 - Tax Rate)) * Rate of return$
12	Equity Rate of Return (PreTax)	21.21%
13	Terminal Multiple of Cash Flow	9 <span style="border: 1px solid black;">CF Multiple = 1/Rate of Return</span>
14		
15		
16		
17	Cable Franchise	ADL Code
18	Initial Capital Expenditure per Subscriber	\$708 QQ115
19	Annual Capital per Subscriber	\$0 Assumed
20	Revenue per Subscriber	\$226 QQ115
21	Expenses per Subscriber	\$172 QQ115
22	Cash Flow per Subscriber	\$54 QQ115
23	Cash Flow growth assumption (per Yr)	1% Real growth - assumed
24		
25	Financial Performance	Year-->
26	Annual cash flows	1 2 3 4 5 6 7 8 9 10
27	Plus Terminal Cash	\$54 \$55 \$55 \$56 \$56 \$57 \$57 \$58 \$58 \$525
28	Total Cash flows	\$54 \$55 \$55 \$56 \$56 \$57 \$57 \$58 \$58 \$584
29		
30	Interest Cost	\$15 \$30 \$28 \$24 \$19 \$16 \$11 \$8 \$2 \$0
31		
32	Net CF Available for Debt Repayment	\$39 \$25 \$27 \$32 \$37 \$42 \$47 \$51 \$56 \$584
33	Debt Repayment	\$0 \$0 \$50 \$50 \$50 \$50 \$50 \$50 \$50 \$0
34		
35	Annual Net CF for Equity Returns	(\$353) \$39 \$25 (\$23) (\$18) (\$14) (\$9) (\$4) \$1 \$6 \$584
36		
37	IRR to Equity	5%
38	NPV Per Subscriber	
39	w/Discount Rate=	21% (\$205)
40		